

**SUMMER RESIDENTS ADVISORY COMMITTEE**  
**POSITION PAPER – OTHER POST EMPLOYMENT BENEFITS**  
**August 14, 2015**

The Summer Residents Advisory Committee respectfully submits this Position Paper for consideration by the Board of Selectmen, the Finance Committee and the Town Manager in developing strategies for funding Other Post Employment Benefits (“OPEB”).

In prior position papers, the Committee has presented recommendations urging budgetary restraint in order to maintain costs at a reasonable level, while making provision for implementation of the Wastewater plan and other infrastructure improvements. The Committee has been pleased that recent budgets have been consistent with SRAC Position Papers, and recommends that the Town exercise continued discipline over budgets, so that the average single family tax bill will not increase at rates greater than inflation. The Committee recommends that during the current fiscal year the Town develop a definitive long term plan for funding OPEB, in implementation of the Budget and Financial Management Policies adopted December 18, 2012 which provide that:

“...the Town should strive to move toward fully funding the Annual Required Contribution (ARC), ultimately developing a funding schedule that fully funds OPEB’s”

As required by State Law, the Town pays 50% of health, dental, life and vision insurance premiums for about 165 Retirees who have retired after 55 with at least 10 years of service, and will be obligated to do so for current employees after they retire. The Town has been paying (and reflecting as a general fund expense) the amount paid annually for insurance premiums of current retirees. It has made no provision for the current cost of future retirees, except for the small contributions made to the OPEB Trust in the last two years.

Although there is no legal requirement to fund these obligations, GASB 45 requires that the Town’s net OPEB obligation be reflected on the government wide financial statement as a liability, and the annual OPEB cost recognized as an expense. The most recent actuarial OPEB valuation provides that Chatham’s unfunded accrued liability totaled \$16.5 million at June 30 2012. It further stated that the Annual OPEB Cost (amount paid out of pocket for current retirees plus an actuarially determined amount to cover future payments for current employees after their retirement) was \$1,220,000 in 2014, although the Town’s actual contributions was only \$733,661, about 60% of the annual OPEB cost. This underfunding of OPEB cost has continued with the result that the total unfunded liability continues to increase above the 2012 level, by nearly \$500,000 per year. Attached is a schedule which estimates the growth in the unfunded OPEB liability through FY2020, on the assumption that current payments and annual

OPEB costs remain at the 2014 level throughout the period, with total unfunded liability exceeding \$20 million in 2020.

The Committee recommends that OPEB be funded annually in an amount not less than the actuarially determined “Annual OPEB Cost” (ARC)

There are several alternatives for funding OPEB. In the event none either of these alternatives is adopted the ARC should be funded out of the tax rate.

**First.** Find new sources of revenue. In the SRAC’s 2014 Budget Position Paper, the Committee recommended increasing the hotel/motel tax from 4% to 6%, which would generate an estimated \$600,000 of added revenue to be earmarked for the OPEB Trust. This amount, plus continued payments for current retirees was estimated to slightly exceed the ARC. The Finance Committee has recommended against any change in the hotel/motel tax, although the focus of their report was on expanding the tax to private rentals, rather than increasing the rate for hotels and motels. This alternative should be reconsidered.

Other potential new sources include use of free cash, although most of available free cash has been committed for other purposes including the five year capital plan.

**Second.** Borrow all or most of the unfunded liability and deposit proceeds in the OPEB Trust. The Committee estimates that annual debt service will amount to about just under \$60,000 annually for each \$1 million borrowed at 3.5% for 25 years, which means that \$20 million would require \$1.2 million of annual debt service for 25 years, about equal to the current ARC. And if the OPEB Trust is fully funded, there presumably would be no additional OPEB budgetary impact since payment for current retirees would be made by the Trust and not be paid out of the general fund budget.

It is of course true that Chatham already has high levels of debt. However, this new debt is not being incurred to fund new projects or needs, but rather to prefund existing liabilities which will become due in the future. Although there will be an added liability on the balance sheet it will be offset by an asset in like amount, the OPEB Trust. The main reason why this alternative is appealing is that the investment return on the OPEB Trust assets over the long term is likely to be materially higher than the interest costs.

Interest rates currently are at an all-time low, but are expected to increase in the not too distant future. Accordingly, this alternative, if it is to be followed, needs to be implemented as promptly as possible, because higher rates will make this alternative less attractive.

**Third.** The 3% Land Bank Tax currently generates about \$800,000 annually and will expire on January 1, 2020. Under this alternative, the Town should now initiate steps to

repurpose the tax and devote 3% of the post January 1, 2020 tax receipts to OPEB. This will provide a funding source which will not impact the total tax rate. It will, however, preempt other potential uses of the land bank tax resource, including a reduction in the tax rate. For FY 17, 18, and 19 the ARC should be funded out of the tax rate or other sources such as a temporary increase in the hotel/motel tax.

The Committee believes continuation of the status quo is not responsible, because the Town is failing to pay the full cost of the commitments it has, and is making to current employees and retirees. Accordingly, the Committee respectfully recommends that prior to adopting the 2017 budget, the Town explore and prepare to implement one or more of the foregoing alternatives for funding OPEB.